No. 71-852

In the Supreme Court of the United States

OCTOBER TERM, 1971

C. D. CONSTRUCTION CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The memorandum opinion of the Tax Court (Pet. App. 6-34) is reported at 29 T.C.M. 1370. The opinion of the court of appeals (Pet. App. 1-5) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on November 30, 1971. The petition for a writ of certiorari was filed on December 30, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, under the circumstances, petitioner was liable as transferee, pursuant to Section 6901 of the Internal Revenue Code, for a portion of the unpaid taxes due from another corporation.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 and of the West Virginia Code Annotated are set forth in the petition (pp. 3-4).

STATEMENT

Proceeding under Section 6901 of the Internal Revenue Code, the Commissioner asserted transferee liability against petitioner for a portion of the unpaid taxes of Charles Town, Inc. (Charles Town) for 1958 and 1959. The basis for the assertion of such liability was the transfer, for an inadequate consideration, of assets of Charles Town to Fairmount Steel Corporation (Fairmount), coupled with a subsequent transfer of Fairmount's assets (also without adequate consideration) to petitioner. Petitioner concedes (Pet. 2) that Fairmount's transfer to it was without adequate consideration, and that if Fairmount was liable as a transferee of Charles Town, then petitioner is liable for a portion of Charles Town's unpaid taxes. Thus, the only disputed question is whether Fairmount was liable as a transferee of Charles Town.

During 1958 and 1959, Charles Town, Inc, operated two horse-racing meets in West Virginia. Fairmount advanced to Charles Town the funds necessary for

operation of the meets pursuant to written agreements which provided that Fairmount was to receive 90 percent of Charles Town's profits from the meets and was to bear any losses. The advances were not evidenced by notes or other debt instruments, were made without security or agreement as to a repayment date, and were not repayable at all to the extent that losses were incurred in the meets. (Pet. App. 2.)

In 1958 and 1959, Charles Town reimbursed Fairmount and, in addition, distributed more than $700,000 to Fairmount as its 90 percent share of the profits. Fairmount reported the profits as income on its tax returns for those years. On audit of Charles Town's returns, the Commissioner determined, pursuant to Section 61 (taxing income from whatever source derived to its earner) and Section 482 (relating to allocations of income between related taxpayers) of the Code, that the entire amount of the profits was taxable to Charles Town. This determination was sustained in *Charles Town, Inc.* v. *Commissioner*, 25 T.C.M. 77, affirmed, 372 F. 2d 415 (C.A. 4), certiorari denied, 389 U.S. 841, but the government was unable to collect the deficiencies from Charles Town. (Pet. App. 2, 19-20, 22-23.)

Petitioner argued below that Charles Town transferred funds to Fairmount in satisfaction of a valid contractual obligation and, in consequence, that the transfers were for an adequate consideration. Petitioner also argued that Charles Town's tax liability was not sufficiently fixed at the time of the transfers to accord the United States the status of a "prior credi-

tor" entitled, under the applicable West Virginia statute (W. Va. Code Ann., § 40-1-3), to avoid a transfer of assets for an inadequate consideration. This latter argument rested on petitioner's claim that, in the earlier litigation involving Charles Town, liability against it was sustained only under Section 482; that such liability is not "self-assessing"; and, therefore, that the liability did not arise until the deficiency notice was issued on June 11, 1962, three years after the last of the transfers.

On the first argument, the Tax Court held that Fairmount's advances to Charles Town constituted an equity investment. From this it followed that Charles Town's transfers were merely distributions of corporate profits, and, under the West Virginia statute, were "not upon consideration deemed valuable in law." Since the transfers left Charles Town with insufficient funds to pay its taxes for 1958 and 1959, Fairmount was liable as transferee under Section 6901. With respect to the second argument, the Tax Court held that the Commissioner's assessment against Charles Town, which was involved in the earlier litigation, rested on Section 61, as well as on Section 482. Since liability under the former provision concededly is "self-assessing," it arose prior to the time of the transfers to Fairmount. (Pet. 6-34.)

On appeal, the Fourth Circuit affirmed the Tax Court's rejection of both of petitioner's arguments. It also held in the alternative on petitioner's second argument that the United States was entitled to prevail under the West Virginia statute even if it did not have the status of a prior creditor. The court of appeals

reasoned that the assets received by Fairmount, as a stockholder in dissolution of Charles Town, would, in any event, be impressed with an equitable trust in favor of all creditors of Charles Town, regardless of when those debts were contracted. (Pet. App. 1-5.)

ARGUMENT

The decision below is correct. There is no conflict or any other reason for further review.

1. In holding that Fairmount's advances constituted an equity investment in Charles Town, the courts below reached the only conclusion compatible with the uncontroverted facts of this case. The funds advanced clearly were at the risk of Charles Town's business, and the distributions, in consequence, were dividends. Under the applicable local statute, they thus were not for an adequate consideration.

Maple v. *Commissioner*, 440 F. 2d 1055 (C.A. 9), cited by petitioner (Pet. 10), is not to the contrary. There was no issue of transferee liability in that case. The only question in *Maple* was whether a partnership which had purchased seedlings from a nursery, and then contracted to have the nursery raise the seedlings for its account was entitled to deduct as farming expenses the fees it paid the nursery for raising the seedlings. The Ninth Circuit's finding that the partnership bore the risk of loss of the seedlings is fully consistent with the decision below. Of course Fairmount bore the risk of loss on its equity investment. But since what it purchased was an equity investment, rather than goods or services, the distributions it re-

ceived nonetheless were without adequate consideration.

2. Petitioner also relies on several cases arising under Section 482 for the proposition that tax liability thereunder is not "self-assessing," and therefore that Charles Town's 1958 and 1959 liability was not fixed until June 11, 1962, when the deficiency notice issued. On this basis it asserts conflict with the Section 482 cases (Pet. 11-14). But, whatever the merits of petitioner's view regarding tax liability under Section 482, there is no conflict worthy of this Court's review. For both courts below found that Charles Town's tax liability rested also on Section 61, and petitioner does not dispute that liability under that provision is "self-assessing." For the same reason, cases involving the accumulated earnings tax, which petitioner also alleges to be not "self-assessing" (Pet. 14-15), are not in point.

3. Finally, there is no conflict with *Stern* v. *Commissioner*, 357 U.S. 39, as petitioner claims (Pet. 8-10). As is apparent from the opinions below (Pet. App. 1-5, 25), both the Tax Court and the court of appeals applied local law, as required by this Court's holding in *Stern*, in determining that Fairmount was liable as Charles Town's transferee.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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